(21)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1925

No. 289 34

THOMAS W. MILLER, Alien Property Custodian, and MUNICH REINSURANCE COMPANY,

Appellants,

against

EDWIN W. POE, STUART S. JANNEY, ERNEST J. CLARK and J. KEMP BARTLETT, Receivers, Etc.,

Appellees.

BRIEF FOR APPELLANTS.

DANIEL O. HASTINGS,
Solicitor for Alien Property Custodian.

HARTWELL CABELL,
Solicitor for Munich Reinsurance Company.

PRINTED IN THE UNITED STATES BY B. H. TYRRELL, PRINTER, 206-8 FULTON STREET, NEW YORK.

INDEX.

TABLE OF CASES CITED.

AUTHORITIES REFERRED TO.

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1923

No. 816

THOMAS W. MILLER, Alien Property Custodian, and MUNICH REINSURANCE COMPANY,
Appellants,

against

EDWIN W. POE, STUART S. JANNEY, ERNEST J. CLARK and J. KEMP BARTLETT, Receivers, Etc.,
Appellees.

BRIEF FOR APPELLANTS.

Statement of Case.

This is an appeal from a decree of the Circuit Court of Appeals of the United States, Fourth Circuit, affirming a decree of the United States District Court for the Southern District of Maryland, in equity, wherein exceptions to the report of a Special Master were dismissed, and the sum of $189,517.16, with interest from the 30th day of January, 1922, and costs, were decreed to be paid to appellees (plaintiffs in the District Court).

Statement of Facts.

This suit was commenced by the appellees here, as receivers for the United Surety Company, under §9 of the Trading with the Enemy Act. A claim had been filed with the Alien Property Custodian as required by the Act, against the assets belonging to the Munich Reinsurance Company which had been taken over and were in the Alien Property Custodian's possession. The Munich Reinsurance Company (hereinafter called the Munich), was made party defendant, and under an order of court was served by substituted process, and appeared.

The suit is for an accounting under a contract (Tr. 14), between the United Surety Company of Baltimore (hereinafter referred to as the United), and the Munich.

The United was organized under the laws of Maryland, in the year 1906, as a fidelity and surety company and to transact burglary insurance. During its formative period, negotiations between the promoters of the United and the Munich were had for the purpose of interesting the Munich, then the largest reinsurance company operating in the United States, in the company being formed. These negotiations contemplated the purchase by the Munich, of a number of shares of the capital stock in the United, and a participation agreement between the two companies whereby the Munich should become jointly interested with the United, in certain lines of direct business to be undertaken by the United. These negotiations resulted, in part, in the contract referred to above which forms the basis of this suit, and which was finally agreed upon between the parties, on March 20,

1906, but which, by its terms, became effective as of January 2, 1906. (This contract will hereinafter be referred to as the Participation Contract.)

The United commenced to do business on January 2, 1906. Sometime during the following summer it developed that statements which had been made by its promoters to the Munich and to certain officers and directors of the United, as to the subscription and payment for a large part of its capital stock, were untrue. On August 25, 1906 a special meeting of the board of directors of the United, at which other interested parties attended, was held in Baltimore. At this meeting it developed that of the capital stock of the United which its promoters had represented to the Munich and other interested parties as having been subscribed for and paid (2312½ shares), had, in fact, never been subscribed nor paid for. The Munich had, in addition to entering into the contract referred to, subscribed and paid for a considerable block of the capital stock of the United. This had been done in reliance upon the truth of the representations made to it as to the amount of capital stock in the United actually subscribed and paid for. At the meeting above referred to, and as a result of the disclosures, the representatives of the Munich at first, on behalf of their company, insisted upon a recission of the Munich's subscription to the stock of the United, and demanded that the money paid on account thereof be repaid. Subsequently, at the same meeting, and upon an undertaking on the part of certain persons present, to subscribe and pay for these 2312½ shares of stock as to which the false representations had been made, the Munich with-

drew its recission and agreed to allow its stock subscription to stand.

In October, 1906, upon his return to the United States, Carl Schreiner, manager of the Munich, having for the first time learned the full details of the developments in the affairs of the United, served notice of recission of the contract of January 2, 1906, upon the ground of fraud as disclosed at the meeting of August 25th. This was resisted by the United, which claimed that the action of the representatives of the Munich present at said meeting in electing to continue their subscription to the stock of the United, after knowledge of the fraud, constituted a waiver for all purposes and estopped the Munich from rescinding the participation contract.

In 1907, the Munich sued in the Maryland courts to rescind the contract, and the United counterclaimed for the amount claimed to be due for the first year's operations under the contract. The Maryland courts sustained the contention of the United and denied the Munich the right to rescind, ordering an accounting for the first year's business. (*Munich Reinsurance Co.* v. *United Surety Co.*, 113 Md. 200). The accounting ordered in this suit was not completed until January 13, 1911 (Stipulation XXXI, Tr. 120).

The Participation Contract provides that it shall continue in effect for a period of five years from January 2, 1906, and thereafter stand as tacitly renewed for further period of five years, unless written notice of a desire to terminate the same be given by registered letter from either party one year previous to the expiration of any term of five years (Art. 12 of contract, Tr. 19). By its terms, the first five-year period would end on January 2, 1911, and one year prior to that

date the Munich, in accordance with the provision, served notice, by registered letter, of its intention to terminate the contract as of January 1, 1911.

On December 24, 1910, one Preston, a director and stockholder in the United, applied, in Circuit Court No. 2, Baltimore City, for the appointment of a receiver of the United, upon the ground of insolvency. (Tr. 86-96). The application was resisted by the United on the ground that it was entirely solvent. While the Preston suit was pending, and before action had been taken by the court, one Bowles, who was a director and stockholder in the United, filed a bill in the Circuit Court of Baltimore City (a different Court but with concurrent jurisdiction), alleging that while the company was solvent, its financial condition was impaired under the laws of Maryland and other states; that it could not transact further business until the impairment was made good, and asked that a receiver be appointed to preserve its assets and wind up its business. (Tr. 96). On the same day, the United filed its answer therein admitting the allegations of the bill and consenting to the appointment of receivers. The court appointed as receivers, three of the appellees, Edwin Poe, Stuart S. Janney, and Ernest J. Clark, and these three, together with Mr. Bartlett, who was appointed co-receiver at a subsequent date, have ever since acted as receivers in possession and control of the assets and affairs of the United. (Tr. 97).

The accounting which had been ordered in the case of *Munich Reinsurrance Co.* v. *United Surety Co.* (113 Md. 200), was not completed and finally filed, until January 2, 1913. The bill had been

filed May 29, 1907. The court of first instance (Circuit Court of Baltimore City), entered its decree on October 30, 1909, dismissing the Munich's bill and referring proceedings to an auditor to state an account between the parties as prayed in the cross bill of the United. (Tr. 117). The case was appealed by the Munich, and on May 6, 1910, the Court of Appeals of Maryland affirmed the decree below and remanded the cause for the statement of account provided for therein. (Tr. 117).

Thereafter, on November 19, 1910, the parties, to facilitate matters, entered into a stipulation (Tr. 118-20), wherein the American Audit Company was authorized as agent for both parties, to examine the records, books and accounts of the United, and to state an account in annual periods beginning January 2, 1906 and ending January 1, 1911.

The final audit was filed on January 2, 1913, and all exceptions by either party were overruled by the Circuit Court of Baltimore City and the audit ratified and confirmed. Both parties appealed and the appeals were finally disposed of by the Circuit Court of Appeals on June 26, 1913. (Tr. 120). This opinion is printed in the record. (Tr. 142-157). The decision of the Circuit Court of Appeals affirmed in part and reversed in part the decree of the lower court, making a further audit necessary. This audit was filed on September 26, 1913 and the amount thereby ascertained to be due by the Munich as of January 1, 1911, together with interest thereon to September 30, 1913, in all, $77,445.79, was paid by the Munich to the receivers of the United on October 2, 1913 (Tr. 120).

In June, 1914, the United's receivers filed a petition in the case which had been brought by the Munich in 1907, for a further accounting. In this case final decree had already been entered and the accounting therein provided for, had been accomplished, and satisfied by the payment of the amount found due from the Munich to the United. The Maryland Court, upon the petition for further accounting, held that the issues in the case as originally outlined in the pleading, had been finally determined and the case closed, and that the court was without jurisdiction to entertain the receivers' petition, (See opinion of the court, Tr. 122-133).

On June 11, 1920, appellees filed a claim under Section 9 of the Trading With the Enemy Act, with the Alien Property Custodian, asking that they be paid the amount therein stated, as a further indebtedness of the Munich to the United under the Participation Contract. The claim not being allowed or paid, the present bill was filed on June 12, 1920 in the United States District Court for the District of Maryland.

Specification of Errors.

The errors relied upon on this appeal, are to be found in the Assignments of Error (Tr. 23 et sec.), numbers 1, 2, 3, 4, 5, 6, 7, 8, 10, 12, and 13. The questions involved in these assignments may be summarized as follows:

1. The court erred in not dismissing the bill for the reason that there had been a material breach of the Contract by the United and its receivers, which should bar any recovery against the Munich thereunder.

2. The court erred in its construction of the contract and ordered an accounting upon an erroneous theory under which the Munich is required to pay a large sum of money, for which it should not be held liable.

3. The account as confirmed, includes many items of charge against the Munich as to which the parties are already foreclosed as *res adjudicata* by the account stated by the Maryland courts in the former litigation.

ARGUMENT.

I.

The court erred in not dismissing the bill for the reason that there had been a material breach of the contract by the United and its receivers which should bar any recovery against the Munich thereunder.

Under the terms of the Participation Contract, the United and the Munich were committed to a joint adventure in certain fields of suretyship and insurance. Presumably both parties were familiar with the technical aspects of the business in which they were to engage and understood the contract which had been the subject of lengthy negotiation.

Under our second point it will be necessary to scrutinize the Participation Contract in order to ascertain whether, in construing its provisions, it is to be classed with what are known as reinsurance contracts or treaties, or whether it more closely resembles a joint adventure, in which the parties, without being partners, share jointly in the fortunes of the common enterprise. We need

here consider it only insofar as it reflects the knowledge of the parties of the exigencies of their common business and their mutual intentions as to the future conduct of the joint enterprise in reliance upon which the contract was agreed to.

The business of insurance, including suretyship (although the latter is not strictly insurance), is based upon "averages". Realizing that losses will occur and that each loss claimant will probably receive many times the amount paid for his indemnity, the underwriter, by building up a volume of business, derives an aggregate income from his policyholders, including the many who will suffer no loss, which will enable him to meet those actually incurred, pay his expenses, and earn a reasonable profit. This "dissemination of hazard", as it has been called, spreads in two dimensions. The business in force at any given time (usually referred to as the portfolio), must be carefully placed with a view to holding the contingent liability in the event of loss, to a minimum amount while deriving income from broad spread and numerous policyholders. But it is equally important, from the standpoint of scientific underwriting, that the hazards of the business be spread as to time. Losses of certain kinds occur more frequently at certain times of the year. Other classes of losses become heavy after financial depression. Burglary losses become accentuated in what have come to be referred to as "crime waves". From a recognition of these facts and their results as shown in the operation of the business, come the regulations of the state departments as to the reserves set aside out of paid premiums. Rates also are calculated upon the experience of a period of

years, usually from five to ten, and the surplus maintained by conservative companies over and above all estimated or expected liabilities is proportionate to the size of the portfolio and the unexpired contingent liability under policies in existence.

In the Participation Contract these principles are reflected in several ways. Article 8 (Tr. 17-18), which prescribes the formula to be used in arriving at profits and losses, makes due provision for premium reserves and loss reserves, but the provision directly bearing on the point under discussion, is Article 12. Therein is provided:

> "This agreement shall take effect as of the Second (2nd) day of January, 1906, and shall continue for a period of Five (5) years from said date and shall stand as tacitly renewed for further periods of Five (5) years thereafter unless written notice of a desire to terminate the same be given by registered letter from either party One (1) year previous to the expiration of any term of Five (5) years.
>
> The 'Munich', however, has the right to withdraw after the expiration of the first period of Five (5) years from this agreement, at the end of any calendar year by giving One (1) year's notice in writing if the transactions under this agreement result in a loss to the 'Munich', . . . the 'Munich' continuing to participate in all insurances coming within the terms of this agreement granted or renewed by the 'United' during the currency of any notice of cancelment, and remaining liable for its share of the claims arising out of such insurances and out of insurance in force at the time of the notice being given, until expiration of the liability thereon."

It is to be borne in mind that under this contract the Munich neither had, nor was entitled to assume any part in the management of the business whose profits or losses it was to share in certain proportions. It was the "passive member" in the joint adventure, and the United was to be and remain the active manager of the joint business for the benefit of both companies. As such manager it was, in a sense, the trustee of the Munich in the conduct and management of the joint adventure and owed that Company the duties usually flowing from such relationship.

The terms quoted above under which the Munich should be permitted to retire from participation clearly indicate that both parties recognized that as to the business in force at the time any notice of cancellation took effect, the interests of each were bound with the other and required a continuance of the relationship as to that business until, by natural expiry, the policy obligations should come to an end. The portfolio, at any one time would consist largely in business upon which annual premiums were to be paid by the assured during the life of the surety or insurance obligation. It would be composed of various classes of obligations which, by their terms, would run for indefinite periods, such as appeal bonds, guardians' bonds, administrators' bonds and obligations of that class. There would be also on the books, annual business such as burglary insurance which, under the terms of the contracts, would expire usually a year from the date they took effect. Taking a miscellaneous portfolio of this character, if rates were properly calculated on an adequate basis and the business allowed to run off by expiry and normal cancellation, the

premiums derived during the period of unexpired risk could be expected to take care of the losses and expenses.

It needs no argument, to accentuate the importance to the Munich of this feature of the contract. When the Munich consented to be bound *to expiry* on all existing business for all losses which might occur, it must have been in contemplation of a normal premium income to be derived from the business and applied so far as it would go to the payment of losses and expenses incurred during the period for which it remained bound.

One year prior to December 31, 1910, the Munich served notice of its intention to withdraw from further participation in the business. The notice was served strictly in accordance with the provision of Article 12, quoted above. Under the terms of that article, the withdrawal became effective as of December 31, 1910. The volume of outstanding contingent liability on the books of the United at that time, in the fortunes of which the Munich was, by the terms of the contract, obliged to continue its interest, amounted to $69,268,458.00, and the annual premium income from the business amounted to $345,525.92 (tr. 63). The testimony of Clark, one of the receivers and an insurance man of experience, (Tr. 53), is:

> "If this mass of business which was left in the office (of the Surety Company), by the termination of this contract, had run to normal (sic expiry), with the United Surety Company as a going concern, the premiums from that mass of business would have taken care of losses if those premiums could have been collected."

The business was not permitted to run to expiry.

As appears in the statement of facts, on Jan. 13, 1911 (the notice of cancellation served by the Munich having taken effect on Jan. 1st), and while a stockholders' suit was pending in another court praying for receivers for the corporation upon the ground of its insolvency, a suit was brought in the Circuit Court of Baltimore City in the name of Thomas H. Bowles. The United was the defendant. The bill in this case alleged that the United was solvent but "impaired" under the laws of several of the states in which it was licensed, and had by these states been ordered to take on no new business. The bill prayed that receivers be appointed to take over and liquidate the affairs of the company. The purpose of this second suit is quite clear and needs no comment. The United at once filed its answer admitting the allegations of the bill, consented to the appointment of receivers, and on the same day the court appointed as receivers, Mr. Poe who was the president of the company, Mr. Clark, one of its directors and a member of its executive committee, and Mr. Janney, its general counsel (Tr. 97).

On Feb. 6, 1911 the receivers petitioned the court for leave to instruct agents to pay out of the balances in their hands to the credit of the United, return premiums on bonds tendered for cancellation. An order to this effect was entered the same day (Tr. 97-98).

This was in effect, an invitation to the agents to protect their friends and customers at the expense of the corporation and its general creditors, as, in the case of eventual insolvency, the pro rata return premiums thus paid in full would be, in effect, a preference. The commission granted was, of course, generously used. It appears from the record (Tr. 180-1) that approximately $125,000 (75%

of $167,412.67) of return premiums were paid out. In other words, by these cancellations brought about by the receivers, the Munich was deprived of over $41,000 (⅓ of $125,000) in money collected as premiums and in the possession of the United and its agents when the receivers were appointed.

On April 10, 1911, the receivers again applied to the court; this time, it was for permission to cancel or lapse the annual business (burglary and plate glass insurance and fidelity bonds), at the yearly date of maturity instead of renewing, when possible, and to bring about the termination of risk in long-term business (suretyship), by waiving the right to collect annual or renewal premiums or any part thereof in exchange for releases from the contingent liability assumed under contracts of suretyship. An order to this effect was entered on the same day (Tr. 99-100).

On December 21, 1911, the receivers petitioned the court again. The petition recites the execution by the company, of judicial bonds of every description; reiterates the belief of the receivers in the solvency of the United, and asks the court to order the receivers to furnish the courts where "United" bonds are still in force, a list of such bonds with request that the judge of such court require substitution of other bonds for those of the United. An order to this effect was made the same day (Tr. 100).

On October 10, 1912, an order was made in the receivership case, at the instance of the receivers, terminating all liability of the United upon its outstanding obligations as of January 13, 1913 (Tr. 116).

This last order was thereafter reversed by the Court of Appeals of Maryland upon the ground that the United, upon the record was solvent and

therefore was bound to the performance of its executory contracts (120 Md. 91).

As we have seen, when the receivers were appointed, the volume of existing business aggregated $70,000,000.00 of contingent liability on policies and bonds outstanding, representing an annual income of approximately $345,000.00. At the end of 1912 (a period of two years), the volume of the outstanding contingent liability had shrunk to $9,000,000.00, with an apparent premium of something over $100,000.00 (Tr. 72-73).

The word "apparent" is used in this connection advisedly. The effect of the voluntary receivership; of the order obtained by the receivers to cancel obligations and return premiums; the lapsing or cancelling of the annual business; the request to courts and judges throughout the country to have other bonds substituted for the United Bonds; and the order directing the cancellation of all outstanding contingent obligations, would inevitably bring to an end all business which could be underwritten by other insurance or surety companies, leaving on the books of the United, policies and bonds under which losses had already been incurred or business so undesirable as not to be attractive to other companies and therefore not transferable.

It is to be borne in mind that for several years after the receivers were appointed, it was constantly insisted by them, in and out of court, that the United was and continued to be solvent. At the time the receivers were appointed, and thereafter, imposing figures were presented to the court as representing the assets of the company and as an evidence of the reiterated claim that it was solvent.

At the trial of this case a very different picture was presented. It developed that no dividends had ever been paid to creditors; that although the receivers had liquidated and realized upon the assets of the United as far as could be done, and had received $77,000.00 from the Munich, they had approximately $16,000.00 in bank. The hope is expressed that they may eventually be able to pay 25¢ on the dollar to creditors. (Tr. 77-8).

Under the decisions, it would seem to be immaterial whether a party guilty of an anticipatory breach of an executory contract, be solvent or insolvent. The adverse party is not concerned with the cause of the breach unless some defence such as impossibility of performance as that term is understood in law, can be shown in connection with the breach.

In *Central Trust Co.* v. *Chicago Auditorium* (240 U. S. 581), this court held that the filing of an involuntary petition in bankruptcy against a baggage, transfer and livery corporation, followed by an adjudication of bankruptcy, was the equivalent of an anticipatory breach of its executory contract with a hotel company for handling the latter's baggage and livery business, where the trustee in bankruptcy does not elect to assume performance. In delivering the opinion of the court, Mr. Justice Pitney said (page 590):

> "The contract with which we have to deal was not a contract of personal service simply, but was of such a nature as evidently to require a considerable amount of capital, in the shape of equipment, etc., for its proper performance by the transfer company. The immediate effect of bankruptcy was to strip the company of its assets and thus disable it from performing. • • •

"It is argued that there can be no anticipatory breach of a contract except it result from the voluntary act of one of the parties, and that the filing of an involuntary petition in bankruptcy, with adjudication thereon, is but the act of the law resulting from an adverse proceeding instituted by creditors. This view was taken with respect to the effect of a State proceeding restraining a corporation from the further prosecution of its business or the exercise of its corporate franchises, appointing a Receiver and dissolving the corporation in *People* vs. *Globe Ins. Co.*, 91 N. Y. 174, cited with approval in some of the Federal Court decisions above referred to. In that case it did not appear that the company was the responsible cause of the action of the State so as to make the dissolution its own act; *but, irrespective of this, we cannot accept the reasoning.* (Italics ours.)

"As was stated in *Roehm* vs. *Horst*, 178 U. S. 1, 19: 'The parties to a contract which is wholly executory have a right to the maintenance of the contractual relations up to the time for performance as well as to a performance of the contract when due.' Commercial credits, are, to a large extent, based upon the reasonable expectation that pending contracts of acknowledged validity will be performed in due course; and the same principle that entitles the promisee to continued willingness entitles him to continued ability on the part of the promisor. In short, *it must be deemed an implied term of every contract that the promissor will not permit himself through insolvency or acts of bankruptcy to be disabled from making performance;* and, in this view, bankruptcy proceedings are but the natural and legal consequence of something done or omitted to be done by the bankrupt in violation of his engagement. It is the purpose of the Bankruptcy Act, generally speaking, to permit all creditors to share in

> the distribution of the assets of the bankrupt, and to leave the honest debtor thereafter free from liability upon previous obligations. *Williams* v. *United States Fidelity Co.*, 236 U. S. 549, 554, 59 L. d. 713, 716, 35 Sup. Ct. Rep. 289. Executory agreements play so important a part in the commercial world that it would lead to most unfortunate results if, by interpreting the act in a narrow sense, persons entitled to performance of such agreements on the part of bankrupts were excluded from participation in bankrupt estates, while the bankrupts themselves, as a necessary corollary were left still subject to action for non-performance in the future, although without the property or credit often necessary to enable them to perform. We conclude that proceedings, whether voluntary or involuntary, resulting in an adjudication of bankruptcy, are the equivalent of an anticipatory breach of an executory agreement within the doctrine of *Roehm* v. *Horst*, *supra.*"

The District Judge who heard the case at bar in the first instance, avoids the application of the declared principles of the Auditorium case in the following language (Tr. 170):

> "By the election of the Munich, the contract ended on January 1, 1911, except for the settlement by one or the other, of the obligations already incurred. Thereafter the Munich had no interest in any new insurance which the United might write. It had no right to require that the United should continue in the business in which it had of its own free will declined to have lot or part. After the expiration of the notice of termination, the United was free to decide for itself whether it would go on, and the Munich had no right to complain that the decision was in the negative. When such a concern ceases

to do new business, it must either in one form or another reinsure its outstanding risks or do what it can to terminate, so soon as may be, its liability upon them. To keep up its complete organization, for the mere purpose of handling insurance already written and such renewals as might be brought about, would be ruinous and no such contract as this between insurance companies can reasonably be interpreted as binding either of the parties to such waste of money. The United tried to reinsure, but so far from being able to do so, it could not find anybody willing to assume its liabilities in exchange for its assets. That is, in the judgment of the other companies who had (238), at its instance, examined its books with a view of taking over its business, it had already incurred obligations which would seemingly entail a loss upon its exceeding the amount of its capital. For a third of the larger part of these losses, the Munich would be liable. In that state of things, all that the Munich could justly require was that the United should, in good faith, exercise reasonable care to wind up its business to the best advantage, and that, so far as the record discloses, is precisely what the receivers did.

"The Munich was to pay one-half of the net liability retained by the United. There was no limitation as to the amount for which it might become bound. When the contract was made, it was quite possible that the obligations which in five years the United might assume, would ultimately entail a liability exceeding its capital and surplus. In that event, it would have to close its doors and liquidate its business, and if it did, according to the Munich's present contention, the latter would be discharged, that is to say, if the United's losses were very great, the Munich would be released from obligation to pay any of them. Such a claim is its own best answer. It is

> therefore unnecessary to decide whether, as the United asserts, the Munich has estopped itself from setting up a defense which has, on other grounds been held bad. The litigation between the two companies continued for years after the United went into receiver's hands, and after the latter had done all in their power to bring about a cancellation of the outstanding risks. Never, until the institution of these proceedings, did the Munich raise the point upon which it now seeks to rely. It allowed all the other courts to assume that it did not dispute its obligation to account at the proper time and in (239) the appropriate proceeding. If for the purposes of this case it be assumed that all this did not work a technical estoppel, it at least shows that the present defense had not then suggested itself to the ingenuity of any of the able, astute and experienced counsel who appeared for the Munich. It is difficult to resist the conclusion that it would not so long have escaped their attention had there been anything of substance in it."

As to the last part of the quotation, a sufficient answer is, that in this case for the first time in all the litigation between these parties, does the question of the effect of the receivers' acts in destroying the existing business of the United, upon the rights of the parties, become relevant. The former litigation involved the accounting for the first five-year period *only*. The acts of the receivers thereafter could have no bearing, and therefore no place in the discussion. In this case these facts are pertinent for the first time, and the question was raised in the initial forum. The appellants are therefore entitled to have it considered not as a last resort of some hair-splitting lawyer, but as an argument seriously made and entitled to due consideration.

As to the question of waiver or estoppel upon the Munich because it sought first to rescind and afterwards cancelled its contract with the United in accordance with its terms, and which the court below does not undertake to decide, it would be difficult to uphold the validity upon such a contention. An unsuccessful attempt to rescind a contract on the ground of fraud could not well be construed as leaving the other party in a position to thereafter observe the provisions of the contract or not as he saw fit. As to the cancellation, when the underlying instrument in precise terms provides for cancellation at the end of any five-year period and in terms equally precise binds both parties, in the event of cancellation, to continue their responsibilities as to the then existing business to its normal expiration, it can hardly be seriously contended that the exercise of the privilege of cancellation has the effect of nullifying the requirement that the business be continued to expiry.

The position taken by the lower court that, after the expiration of notice of termination the United was free to decide for itself whether it would go on and the Munich had no right to complain that the decision was in the negative, followed by the argumentative statement that unless the United could reinsure the existing portfolio which it tried and failed to do it would have been foolish to continue its organization merely for the purpose of running off the business then on its books, is, we submit, an invasion of the rights of the parties to make and enforce their own contracts. The terms of the contract are specific (Art. 12, pp. 19-20). In providing for a joint participation in this business "until expiration

of the liability thereon", the word "expiration" is to be construed in the insurance sense as contrasted with termination of liability by cancellation. The purpose of the parties is further evidenced by Article 13, in which careful provision is made for rendering accounts with respect to the business being run off and carrying proper reserves for outstanding claims. Many defendants have been heard in courts to plead inability to carry out the terms of a contract made by them, either by reason of lack of funds, change in circumstances, or other plausible pretext. As early as *Thornborow* v. *Whitaker* (2 Ld. Raym. 1164, 1705), the English courts told an unfortunate defendant who found that under a contract he had entered into with considerable lack of foresight, he was called upon to pay to the other party more rye than was grown in a year in all England, that that was a misfortune, probably not his fault, but was no answer to the demands of his adversary. Such defenses have rarely been successful in court. In the case at bar, however, we have the plaintiffs asking for, and in the lower courts obtaining, affirmative relief against the defendant in the face of an anticipatory breach of the contract on their part, the effect of which was to destroy the safeguards which the defendant had reared by the provisions of the contract, against the probability of its having to pay the large sum now demanded of it.

If the reasoning of the court below is sound, it would seem that in *Central Trust Co.* v. *Chicago Auditorium,* the liability of the bankrupt estate could have been avoided by a showing on the part of the receiver in Bankruptcy that he had tried to get someone else to take over the contract, without success, and that it would have been

inconvenient, impractical, and an undue burden on the estate to continue its organization and operation to carry out a single contract.

II.

The court erred in its construction of the contract and ordered an accounting upon an erroneous theory under which the Munich is required to pay a large sum of money for which it should not be held liable.

In his opinion the learned judge in the District Court erroneously, as we think, referred to the contract as one of "reinsurance".

Reinsurance has a definite meaning in law and the rights and obligations of parties to such a contract have been formulated and enforced by our courts for more than a century. The legal conception of the relations between a reinsurer and its reinsured has been so far crystallized, that this Court, in one case, refused to allow the parties themselves, by the language of the agreement, to vary the recognized legal effect of such contracts. (*Allemania Fire Ins. Co. v. Firemen's Ins. Co.,* 209 U. S. 326.)

If the so-called Participation Contract is to be construed as an agreement for reinsurance, then two things follow: First: the reinsurer is to be credited for earned premiums on reinsurances effected thereunder, whether the reinsured company succeeds in collecting its own premiums from its policyholders or not, and, Secondly, the reinsurer owes to the reinsured company its proportionate amount of the losses occurring under the latter's

policies without regard to the actual payments received by the policyholders from the direct writing company.

If, on the other hand, as we contend, this contract embodies a joint adventure and not a reinsurance, the results are the reverse. The Munich, sharing in the fortunes of the United, can only claim credit in its settlements with that company, for its proportion of the premiums actually collected by the United from its policyholders, and in turn should bear only its share of the losses actually paid by that company.

The relief granted in the courts below is consistent with neither theory. The Munich is confined to a credit of premiums on the basis of actual collections by the United from its policyholders, but is required to pay its full share of the losses *incurred* by the United although it is admitted that these losses have never been paid and that only a small percentage of them will be realized by loss claimants, even if the full amount prayed for is collected from the Munich.

(a) *On the theory of reinsurance the Munich is entitled to a credit for all earned premiums without regard to the collections by the United from its policyholders.*

A number of the definitions of reinsurance to be found in the text books and reports are collected in I Joyce on Insurance, §112 (2nd Ed. p. 342). The one taken from Phillips (1 Phillips on Insurance, 3rd Ed., 209) is typical, and reads as follows:

> "A contract whereby one party called 'the reinsurer', in consideration of the premiums paid to him, agrees to indemnify the other

against the risk assumed by the latter by a policy in favor of the third party."

For many years the practice of underwriters was to effect separate reinsurances with respect to specific policy liabilities. This entailed the trouble and expense of negotiating and making one or more contracts with other Companies for each policy written to cover a greater liability than they were willing to assume, and in recent days, when property owners and businessmen demand a limited number of large policies in place of a multitude of small ones, the custom has grown up of entering into running contracts for reinsurances (ordinarily called treaties), under which reinsurances of policy obligations are effected more or less automatically by means of bordereaux or notices, of the issue of policies by the reinsured company, sent to the reinsurer.

Whether effected specifically in each case or by treaty, the elements of the contract remain the same. The premium paid is usually a proportionate part of the original premium charged by the Reinsurance Company, less deduction allowed as representing the acquisition cost of the business to the reinsured company. This acquisition cost to the direct writing company includes agents' commission, brokerage, local licenses and taxes.

There is no privity between the reinsurer and the third person whose property is the subject-matter of insurance. It is not the interest of this person in the property which is insured, but the interest of the Company which issued the original policy, the Courts holding the fact that the original insurer has assumed a risk to give such insurer an insurable interest in the subject-matter

of its insurance, and prevents reinsurance taken out by it from being a wager contract.

> *New York Bowery Insurance Company* v. *Insurance Company,* 17 Wend. (N. Y.) 359;
> *Philadelphia Insurance Company* v. *Insurance Company,* 23 Pa. St. 250;
> *1 Phillips on Insurance,* §375 (3rd Ed.).

Because the interest insured is not that of the owner but of the first insurer, the contract is not within the statute of frauds.

> *Bartlett* vs. *Firemen's Fund Insurance Company,* 77 Iowa 155;
> *1 Joyce on Insurance,* 2nd Ed., § 116, p. 352.

It has also been held that the term "reinsurance" is not indispensable, but that an ordinary policy of insurance may be issued by one underwriter to another. It is reinsurance in fact, whatever it may be called, if the interest insured originates in the issue of insurance coverage by the insured to someone else.

> *Home* v. *Mutual etc. Insurance Company,* 3 N. Y. Super. Ct. 137-151.

Moreover, the Courts hold that contracts of reinsurance when sued on are open to all defenses of an independent contract, regardless of the underlying contract with the third person.

> *Sun Mutual* vs. *Ocean Insurance Company,* 107 U. S. 485.

Taking the proper conception of reinsurance to be a distinct, independent contract whereby one underwriter indemnifies another against all or a certain portion of the liability assumed by the latter in a policy issued to a third person, certain results are at once apparent:—

The subject of insurance being *liability under a contract*, and not loss or damage to property, the reinsurer must pay the whole amount of his obligation to the reinsured, whether or not the latter pays anything to his policyholder, and is entitled to receive his premium without regard to collection by the reinsurer from the original policyholder.

(b) *If this be a joint adventure, then under the language of the contract the United can only call for settlement by the Munich upon the basis of losses actually paid by it.*

We have, from the inception of this suit, urged that this is not reinsurance, but a joint adventure, or as the Maryland court has called this particular contract, a "Participation Agreement", (Opn. in *Poe* v. *Receivers*, 121 Md. 479, See Tr. 149), whereby one company agrees to share in the losses or profits accruing with respect to certain lines of business transacted by the latter, the sharing to be in certain proportions based upon annual statements to be rendered by the company transacting and managing the business, to the other. The charges and credits to be used in determining loss or gain are specifically prescribed in the instrument itself.

While there is a so-called "ceding" of a certain proportion of each policy mentioned in Article 1 of the contract, the evident purpose of that article

is to prevent the United, in the annual accounting, from charging the Munich with more than its share of losses or *net* retentions of the United. There is nothing in the contract providing for the payment of premiums to the Munich and no consideration which would support an independent contract of reinsurance.

The Munich in effect has by this agreement said to the United: We will take a one-third interest in certain lines of your business; we will let you have the sole management of it; issue your applications in prescribed form; collect your premiums; pay your agents and brokers whatever you see fit, and settle your losses. At the end of the year you shall account to us and include in your account, the proper proportion of your overhead prorated between the lines of business in which we have this one-third interest and your other lines in which we have no interest. If this account shows a profit to you, we take a third; if it shows a loss, we pay a third.

There is no partnership here because the idea of mutual agency, inseparable from a partnership, is absent. One party takes entire control of the business, and the rights and obligations of the other are to pocket his share of the profits or pay his share of the losses, as the case may be. When you take into consideration that this contract was coupled at its inception with a large subscription by the Munich for stock in the United, the transaction as a whole comes close to "grub staking", so usual in the days of mineral prospecting. Whatever it may be—a participating arrangement, a joint venture, or a backing of one Insurance Company by another for a chance to share in the profits that may accrue, it is certainly not a *reinsurance contract.*

If we look at the contract itself to determine the extent of liability thereunder, unhampered by any preconceived legal measure of liability which attaches to a reinsurance contract, our way is fairly clear.

Article VII (Tr. 17) provides for the profit and loss account to be rendered at the end of each year by the United to Munich on which profits and losses is in Item 3 of the disbursements "Claims *paid,* less salvage and reinsurance in other Companies."

In Article XIII (Tr. 20), it is provided that in the event of termination of the contract:

> "In case of notice of termination by either party the accounts shall be made up not later than two years after the expiration of the notice. Such accounts shall not be charged with any premium reserve. If claims are still outstanding the proper reserve shall be charged and *after final settlement* of each of such claims the Munich will be paid any difference in its favor and pay any difference in favor of the United."

This again looks to *ultimate* payment—a *final settlement* of outstanding losses as the only basis on which the Munich is to be bound. If any doubt arises that "settlement" here may mean the determination of the amount of an insurance obligation, ordinarily called by insurance men "an adjustment", and if the word "final" is urged to be superfluous, the parties here in another clause of the contract, have clearly indicated what they mean by "settlement". Article VI (Tr. 13) provides, "The Munich shall also be advised of all claims *settled,* by monthly lists showing *payment* to the assured and cost of settlement as per annexed form."

In passing upon this point, the Court below says, (Tr. 171):

> "It (Munich) argues that final 'settlement' here means payment. So to hold would run counter to the whole scheme of the agreement between the Companies. What the Munich assumed was one-third of the liability. . . The words 'final settlement' as used in this contract must be held to mean the fixing by agreement or judicial determination of the amount due by the United on the bonds or policies for which the Munich assumed a one-third liability."

With all due respect, the Court itself has run counter to the whole scheme of the agreement between the parties. There is not a line in the contract whereby the Munich is required to pay a third or any other part of the liability of the United on any specific bond or other obligation. The only payment it is required to make is its proportion of the loss resulting from each year's operation,—after taking into account numerous overhead expenses, items such as taxes, office rent, advertising, printing, etc., etc., and by the terms of the contract this loss is to be calculated, not upon the liability of the United under its bonds and outstanding obligations but upon "*Claims paid*, less salvage and reinsurance in other Companies." Since none of the claims against the United which form the basis of the accounting herein have been paid, the judgment and decree of the Court below should be reversed and the bill ordered dismissed as prematurely brought.

III.

The account as confirmed, included many items of charge against the Munich as to which the parties are already foreclosed as res adjudicata, by the account stated by the Maryland courts in the former litigation.

The Participation Contract provided that accountings and settlements were to be made for each year's business. An accounting for the first year (1906), of the contract term was ordered by the Maryland court in the case instituted by the Munich for a recission of the contract wherein the United had, by cross bill, demanded an accounting for this first year which had ended shortly before the suit was brought. The lower court dismissed the Munich's bill but entertained the cross bill of the United and ordered an accounting for this first year. The case went to the Maryland Court of Appeals, where it was not decided until May 6, 1910 (Tr. 117). The lower court was affirmed.

On November 19, 1910 the parties, their rights having been determined, and the status of the contract between them as to the first five-year period having been settled as a result of the decree, entered into a stipulation (Tr. 118-119) whereby the order of the first year's accounting is enlarged to embrace each year for the first five-year period. This stipulation in part reads:

> "First: The said Munich Re-Insurance Company and the said United Surety Company do hereby constitute and appoint the American Audit Company their agent to examine the records, books and accounts of the

United Surety Company and therefrom to state an account in annual periods beginning 2nd January, 1906, and ending on January 1st, 1911, applying to the share of the Munich Re-Insurance Company in the business of the United Surety Company as per their contract above referred to.

"Second: The Munich Re-Insurance Company and the United Surety Company will each delegate one of their employees to assist in such accounting and all amounts passed by the American Audit Company and to which no objection has been raised by either of the delegates, shall be deemed to be accepted by both parties, and the fact and amount of any item of receipt or disbursement by said Surety Company as found by said Audit Company shall likewise be conclusive upon the parties hereto, the facts and circumstances surrounding such item (unless agreed to) and the relevancy thereof to the accounting between the two companies being alone left open for future determination. The audit, however, shall not extend to outstanding liabilities for unexpired risks or claims not yet settled; both the outstanding liabilities for unexpired risks and claims not yet settled are reserved for future adjustment between the parties under the terms of the contract."

In due time the American Audit Company accomplished its work and submitted its report, and the parties then proceeded with the accounting before the court auditor to whom the case had been referred in the suit then pending between them.

The court auditor did not complete his work and submit his report to the court, until January 2, 1913. At a hearing then had on Motion to Confirm, all exceptions filed by both sides to the auditor's report were overruled and the report confirmed. Both parties appealed. On June 26, 1913

the Maryland Court of Appeals reversed in part and affirmed in part the decree of the court below confirming the account as stated, and remanded the case upon order to re-state the account between the parties to conform to its decision (Tr. 120).

The account was re-stated and ratified by the court in September, 1913 and the balance found to be due from the Munich ($77,445.79), was paid to the receivers of the United on October 2, 1913.

It is to be borne in mind that the Munich, prior to this, and in the latter part of 1909, had availed itself of its right under the contract, and served notice upon the United of its intention to terminate the contract as of December 31, 1910. The five-year period covered by the audit as provided for in the stipulation between the parties therefore covered the entire period as to which, under the contract, the parties had a participation in the entire volume of business transacted in given lines by the United.

The wording of the stipulation of November 19, 1910 clearly indicates that the accounting then to be had was intended to cover all questions between the parties as to the business of the five-year contract period, leaving open "outstanding liabilities for unexpired risks or claims not yet settled". The language of the stipulation, "both the outstanding liabilities for unexpired risks and claims not yet settled are reserved for future adjustment between the parties under the terms of the contract", clearly indicates a deliberate intention that everything between them is to be settled except the matters expressly reserved.

In the account as finally stated in the state court case (Tr. 157-165), the joint business for

the five-year period is credited with the gross premiums of $454,844.42 (Tr. 161). In the account as confirmed by the courts below in this case there appeared a credit of $167,421.67 as "return premiums and rebates" which had been allowed since January 1, 1911. In the stipulation of facts herein it is agreed (Tr. 180), that 75% of this item represents return premiums allowed on bonds on which premiums were charged *prior to January 1, 1911 and credit therefor given in the account ratified in the state court.* In other words, in the present accounting the receivers have been permitted to open the account stated between the parties in the state court in 1913, and to charge back against the Munich about $125,000.00 of premiums as having been returned by the United which, in the first accounting between the parties had been created to the business as an asset in connection therewith in arriving at the balance due from the Munich.

From the stipulation between the parties entered into for the purposes of facilitating the accounting in the court below (Tr. 178-183), it appears that a part of this $125,000.00 represents premiums actually returned by the receivers in the cancelment of the Company's obligations; that as to the remainder, the defendants below denied that it consisted of "return premiums and rebates", as that term was used in the contract. This contention was based upon the undisputed fact that premiums which had been credited up as assets, but which afterwards proved uncollectible, had been charged off as "return premiums."

With the propriety of this we are not at present concerned. The question here, is whether

either party, in the absence of fraud or mistake, can open an account stated for the purpose of charging the other with items for which he received a credit in the stated account. There is no question of mistake or fraud as the actual return premiums were made with full knowledge of the facts, and the so-called return premiums which had in fact never been collected and were judged to be uncollectible, are merely bookkeeper's entries.

To arrive at the rights of the parties it will be necessary to review at some length the decision of the Court of Appeals in Maryland under which the original account was stated.

In the audit approved by the lower Court of Maryland there was an item of "Premium reserve for unexpired risks $185,698.88" under the head of disbursements. The Munich sought to eliminate this item and the Court of Appeals did eliminate it. In its opinion the Maryland Court said: (Tr. 149).

> "The question as to the extent to which the premium and claim reserves should be considered in the accounting requires a reference to the relations of the contracting companies to each other at the time of the preparation of the audit. So far as the annual accounts mentioned in Article VIII of the participation agreement are concerned it is distinctly provided that both classes of reserves shall be included. But there is an equally express provision in Article XIII that if notice of termination is given by either party, the account to be stated (212) after the expiration of the notice shall not be charged with any premium reserves. The privilege of withdrawal was secured to the parties by Article XII, as above quoted, and was exercised by the Munich Company in the manner prescribed, with the

result that the contract ceased to be operative, except as to business already subject to its terms, when the original five year period expired on January 2nd, 1911. The auditor's account was prepared in December 1912, nearly two years after the withdrawal of the Munich Company from the agreement. In consequence of the litigation between the parties no settlement ever occurred as to any part of the business to which the contract applied. The present accounting must accordingly include the annual ascertainment of profit and loss required to be made during the currency of the contract *and also the settlement for which it provides after the expiration of the notice of withdrawal.* The audit as filed is composed of five annual statements in each of which both premium and claim reserves are charged as disbursements. The statement for the final year of the contract will illustrate the method and theory of the accounting for all of the annual periods."

* * * * * * *

(Tr. 151).

"It is explained by the testimony that the premium reserves for unexpired risks represent a portion of the annual premiums set apart as unearned until the expiration of the year for which they are paid in advance. At the end of the term for which the premiums are received the reserve is released and becomes available as current income. A new reserve is then created out of the premiums paid for the succeeding period. In the annual accounting for which the agreement provided the gross premiums were to be included in the income, and the proper deduction of the unearned portion was to be accomplished by charging premium reserves among the disbursements. The next accounting, however, would give the parties the benefit of the fund

thus reserved by treating it as income under the description of 'Reserve for Unexpired Risks at the end of the previous year.' The same disposition was to be made with respect to the reserve for claims, which, as the designation suggests was composed of amounts estimated for actual but unsettled losses. This reserve was intended to meet a real though unascertained liability to which both parties to the contract were subject in the proportions specified, while the premium reserve had no such purpose, but was provided merely as a suspension to that extent of the (215) right of the Surety Company to use the premiums as ordinary income until the expiration of the full period for which they were received.

"In charging the reserves of both classes as disbursements in the annual accounts for the four years prior to the notice of withdrawal the audit is in conformity with the express provisions of Article VIII to that effect. *But in the accounting for the business of the last year under the contract we think the terms of Article XIII are clearly applicable.* The notice of withdrawal to which that article refers having been duly given, it is directed that the account be made up not later than two years after the contract has been thus terminated and that no premium reserve be charged. If the previous accounting contemplated by the agreement had been effected by the parties, the only business left open for adjustment when the contract expired would have been that which pertained to the final year. It could not have been intended that as to this period there should be two accounts, one prepared under Article VIII including premium reserves as disbursements, and a later one under Article XIII from which such a charge should be excluded. The primary purpose of the annual statements was to show the profits or losses which the parties were to

share. While the contract was in current operation there was no prejudice to either party in charging the premium reserves as disbursements for the reason that these items would be credited as income in the (216) account for the succeeding period. But when the agreement is no longer in effect and the accounting deals with the last year to which it can apply, the conditions are altogether different. The premium reserve could not in such a situation be used as a factor in determining the actual profit or loss upon which the settlement for that year depends because such a reserve as provided under this agreement, represents in fact neither a liability nor an expenditure. It was manifestly upon this theory that the contract excluded the premium reserve from the accounting to be stated after its expiration, and in order that credit might not be given for premiums which were not fully earned it provided for an extension of the time for the accounting until this item could properly be treated as income. In our judgment, the audit, which, as previously noted, was filed near the close of the two year period allowed for making up the account of the business for the last year, and at a time when the premiums received for that year were fully earned, should not have charged as disbursements the premium reserve estimated as of January 1, 1911, and the exception which questioned the propriety of such a charge should have been sustained."

* * * * * * *

(Tr. 153).

"By the terms of the contract the Munich Company's shares of losses or profits were payable promptly upon their annual ascertainment, and if they had been so paid, it is clear that there would have been no occasion to reopen the accounts thus settled, except as the claim reserves for the final year under the special provision for that purpose.

"The United Company is entitled unconditionally to the amounts found to be due it for the four years prior to the notice of withdrawal, as evidently intended by Articles VIII and IX of the contract, and the results thus determined are not dependent upon the accounting for the last year of the business, which is placed upon a (219) separate and distinct basis by the provisions of Article XIII. From the account for this final period the item of $185,698.88 as a premium reserve for unexpired risks should be eliminated. The trust created by the decree passed by the Court below would eventually accomplish this object, but we see no reason to require the Munich Company to pay out, even for a limited period, a proportionate part of the large sum just mentioned, when it is certain that the premiums for which the reserve was originally provided have long since become fully earned. The charge for claim reserves should be retained in the accounting, as contemplated by Article XIII. With the premium reserve excluded from the disbursements the account for the fifth year would show a loss of $30,247.48. One-third of this amount will be payable by the Munich Company to the receivers of the United Company as an ascertained liability, *the parties remaining accountable with respect to outstanding claims as provided by the agreement.*" (Italics ours.)

In order to further emphasize the fact that all question of premiums between the parties was settled by this decision, attention is called to the item of "reimbursement for good will".

Article XIII of the contract provides that:

"It is especially agreed that in case notice of termination is given by either party under this Agreement the 'Munich' shall receive as reimbursement for good will five per cent.

(5%) of its share of the net premiums, i. e., premiums less cancelments, of the last five years previous to the expiration of the notice of termination of this Agreement."

In the same opinion quoted above (Tr. 156) the Court upon this point said:

> "It is our conclusion, therefore, that the Munich Company should be credited with five per cent. of its share (one-third) of the net premiums received from the specified classes of business during the period of agreement."

It will be seen, therefore, that at the time of this accounting the Munich was given credit as "Reimbursement for Good will" one-third of five per cent. (5%) of the premiums for the five years. If, at this time, this account is to be re-opened and a deduction made for premiums received during those five years, it would effect this item of "Reimbursement for Good will" also, which, certainly, was not intended. This is a further illustration of the fact that the account had been entirely closed except as to contingent liabilities on outstanding bonds.

The conclusion of the Court is as follows (Tr. 157):

> "The accounting in this case does not affect the ultimate liability of the Munich Company with respect to obligations issued by the United Company and covered by the participation agreement, as to which defaults are not now but may be hereafter, disclosed. For the protection of potential claims of this nature, as between the United Company and the holders of its bonds and policies, provision has been made in the form of a premium reserve directed in the proceeding reviewed by this Court in United States *vs.* Poe *et al.*, Re-

ceivers of the United Surety Company, 120 Md. 89. This premium reserve there provided, and whose function is clearly and thoroughly discussed in the opinion by Judge Stockbridge, rests (224) upon a different basis from the bookkeeping charge bearing that designation which is stipulated in the contract with the Munich Company as one of the factors in the annual ascertainment of its share of the losses or profits. This item is excluded from the accounting as to the last year of the agreement because there is an express provision to that effect in recognition of the fact that such a reserve is not justly pertinent to the determination of the actual results of the business and of the amount properly payable by one contracting party to the other for the final period. The Munich Company, however, is concededly responsible for its due proportion of all losses which may eventually develop from the insurance covered by the agreement."

In disposing of this point, the court below said (Tr. 188):

> "The next exception is to the allowance for return premiums in respect to business prior to January 1, 1911. This exception is on the theory that an allowance of this sum should have been included, if it was not, in the decree of the Circuit Court of Baltimore City heretofore mentioned and all claims on account of it are consequently *res adjudicata*. As a matter of fact, none of these premiums, as I understand it, were returned or allowed for until after the period of account covered by the decree in question. Exceptions therefore cannot be sustained."

It is not entirely clear whether the court, in this disposition of the question, fully understood the

situation. The point made, was that every controversy between the parties had been settled by the decree in the Court of Appeals of Maryland except the Munich's proportionate share of losses which might eventually develop from the insurance covered by the agreement. That this was the intention of the parties appears from the stipulation of November 19, 1910 (Tr. 118), and was the understanding of the Maryland court as appears from its decision quoted above. Moreover, the same court, when petitioned for a further accounting in the same case (126 Md. 520, Tr. 129), again stated its position and reiterated its former decision:

> "It, therefore, followed that when the audit was stated in December 1912, the premium reserve for 1910 was released and the net premiums on which the five per cent for goodwill was to be allowed were known. Consequently, when the account for the last year (1910) was stated, it was proper to have the settlement for which the contract provided, and that was done. In other words, as the parties had by their agreement of November 19, 191 agreed that the settlement should be made for the five-year period according to the contract, and as the contract excluded the premium reserve from the last year and provided for the five per cent. for goodwill being allowed the Munich, a proper accounting for that year necessarily included the settlement provided for after the expiration of the notice."

Again, in the same opinion (Tr. 133):

> "The only items left open after the decision in 121 Md. are the reserve for claims and the ultimate liability of the Munich Company with respect to obligations issued by the

United Company, which were covered by the participation agreement, 'as to which defaults are not now, but may be hereafter disclosed.' "

It is submitted that in the former litigation between the parties it was held that the final account (to be made up not later than two years after the expiration of the notice (of cancellation)), was had, and is conclusive upon both parties as *res adjudicata;* that the only open item in an accounting between the parties, are the claims outstanding when the first accounting was had, as to which, in the langauge of the contract itself (Art. XIII, Tr. 20), "after the final settlement of each of such claims, the 'Munich' will be paid any difference in its favor and pay any difference in favor of the United."

The decision of the Circuit Court of Appeals of the Fourth Circuit, affirming the decree of the District Court should be reversed.

Respectfully submitted,

DANIEL O. HASTINGS,
Solicitor for Alien Property Custodian.

HARTWELL CABELL,
Solicitor for Munich Reinsurance Company.